

**Summary**  
**of the audit on the operation of Hungary's monitoring and control systems of EU financial assistance (0723)**

The audit on the use and utilization of EU financial assistance has a special place in the strategy of the State Audit Office of Hungary (SAO). In 2000 and 2002 the institution carried out its respective audits on the monitoring system of pre-accession funds. However, in the period since Hungary's EU-accession, this present audit was the first to comprehensively evaluate the operation of the national monitoring and control systems of EU financial assistance and the efficiency and effectiveness of this operation.

The 2006 EU financial assistance appearing in Hungary's central budget was budgeted for HUF 300 billion, while the central budget's related national co-funding was budgeted for HUF 130 billion. In addition, the Budget Act estimated that the direct payments to producers and the funds for agricultural market measures (both are off-budget in Hungary) would amount to more than HUF 170 billion. The 2007 Budget Act made plans for the spending of the EU-financial assistance of more than HUF 470 billion, the central budget's relevant national co-funding of HUF 150 billion, and off-budget financial assistance of about HUF 190 billion in the direct payments and the agricultural market measures' areas.

The establishment and operation of the national monitoring and control systems on EU financial assistance that Hungary actually received in 2006 satisfied the relevant requirements for drawing and using EU funds. However effectiveness and efficiency in the systems' operation was different at the individual financial assistances.

A single national strategy was not in place for spending the different EU funds in a coordinated way in the period of 2004-2006, thus synergic effects from coordinating national and EU Funds could appear only to a minor extent. (Environment protection and transportation infrastructure development are exceptions to this statement.) The monitoring of the different kinds of EU financial assistance appeared to be different in terms of effectiveness and efficiency. These differences took form in the impacts of the very interventions made in response to the exceeding of the time limits for the implementation processes and to non-compliances with plans.

Despite the existing recommendations, the time requirement for channeling the funds to the recipients could not comply with the time constraints imposed by legislation. Some projects with financial assistance from ISPA and the Cohesion Funds experienced excessive costs, which led to a decrease in the EU's share of their funding, and this makes it necessary for the Hungarian central budget and local authorities to spend additional resources. The achievement of the specified non-pecuniary goals was hindered at some of the EU-assisted technical

programs by shortcomings in the indicators of the programs and individual projects, and by the delay in program-level evaluation. The achievement of the specified program goals has failed at some of the financial assistances. (The goals to achieve regional convergence and a more balanced distribution of the financially assisted projects among the small regions failed.) Furthermore, the mentioned delays increase the risk of resource utilization.

As from July 2006, 57 % of the institutional background has undergone a reorganization, while the reorganized rate attained 73 % at the institutions (“mediators”) channeling the resources of the Structural and Cohesion Funds. The delay of the reorganization adversely influenced the continuous maintenance of arrangements for monitoring and control and increased the risk in asserting management control (checks prior, simultaneous or subsequent to the processes). Uncertainties arising from institutional reorganizations resulted in an increase of the time demand for disbursements.

The rationalization of available human resources resulted, on one hand, in reasonable fusions of units, but, on the other hand, in creating for some professional fields an array of human resources, the composition of which adversely influenced the provision of the technical monitoring services. The outsourcing of services to external providers has begun and become more and more widespread, and was accompanied by another evolving and spreading phenomenon: the institutions’ service provision is becoming limited to the governance (“management”) of the services.

The lack of a single monitoring system on the use of financial assistance was a setback for the transparency of the use of EU funds. Neither was a single IT system in place to assist the evaluations. Using statistical figures gained from data banks, the technical reports draw conclusions, which were not always well-substantiated. For instance, the annual report, which was submitted to the EU in June 2006 on the use of the Community Support Framework, stated a figure of 53.000 for the indicator “newly created jobs”. However, in the course of the SAO’s audit the respective audited organization couldn’t reproduce the underlying data (statements supported by grant contracts) to substantiate this figure.

The IT system could not turn into a tool that can monitor and evaluate the non-pecuniary processes, and it could assist the SAO’s audit to a limited extent. The reasons for this were the lack of a single IT development strategy, the limited usability of monitoring indicators, and the delays in IT developments and in the deployment of newly developed IT. Furthermore, the missing regulations meant a risk for the IT safety area.

The Hungarian control system of EU financial assistance has been set up in the period of 2004-2006 in alignment with EU and national regulation. The system to prevent, treat and ending irregularities has been set up in the same period as well.

Differences were experienced in how effective the control systems of the different kinds of financial assistance were. The differences arose from the shortcomings in audit methodology implementation, the instability of the audit units at institutions that implement the financial assistance process, and from the fact that in the course of institutional development the interest has shifted from the points of audit activity effectiveness and efficiency. Concerning the institutions<sup>1</sup> that channel financial assistance toward the recipients, their respective – functionally independent - internal audit units were in a different situation in terms of the internal workforce available for them.

No systematic arrangements were in place to evaluate the economy and efficiency of audit activities carried out by the institutions channeling EU financial assistance. Economic evaluation on the utilization of results from such audits did not become a common practice. A well-established and reconstructable (traceable) practice of risk assessment and sampling has not evolved either, and the high risk involved in the “large-scale project” category was not adequately taken into account.

In context of the changing tasks of the period of 2007-2013, Hungary’s regulation system was amended in due time for enabling the adequate operation of the monitoring and control systems. Neither the National Development Agency (“Managing Authority”), nor the Ministry for Agriculture and Rural Development has developed a detailed timetable on the implementation of the preparatory tasks of the new period. In lack of such documents, the adherence of task implementation to a “plan” can not be required and neither can applicants plan their own preparation for the new period.

In addition to the rationalization of the fund channeling arrangements, further risks are in place through the fact that the needed volume of resources (human, IT, etc) were derived from factors other than the volume of services to be provided and their demand for technological capacity. It was not possible to measure cost efficiency in the operational budget of the new institutional system, since its extent of detailedness was not adequate for this.

With the aim to rectify the detected factors that impair efficiency and effectiveness, the SAO developed recommendations for the government ministers heading the Prime Minister’s Office and the Ministry for Agriculture and Rural Development. It was recommended to develop a timetable for the preparatory tasks, to strengthen technical monitoring and its IT support, to develop audit processes that do pay attention to the risks of the large-scale project category, and to arrange for keeping separate records, with adequate detailedness, on the operational cost of the individual institutions.

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<sup>1</sup> With the exception of the Ministry of Agriculture and Rural Development (“FVM”)